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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

ARCH C. SCURLOCK, ARTHUR W. SLOAN, JAMES M. JOHNSTON, MALCOLM F. SCHOEFFEL, FRANKLIN C. SALISBURY, and ATLANTIC RESEARCH CORPORATION, *Petitioners,*

v.

SAMUEL MELTZER, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above styled case on April 9, 1964.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is reported in 330 F. 2d 946. The opinion of the United States District Court for

the Eastern District of Virginia is unreported. Both opinions are contained in the transcript of record certified to this Court by the Clerk of the United States Court of Appeals for the Fourth Circuit and as printed in the Appendix to this Petition.

JURISDICTION

The date of the judgment sought to be reviewed and the time of its entry is April 9, 1964. The date of the Order Denying Petition for Rehearing is May 20, 1964. The dates of the orders staying issuance of a certified copy of the said judgment in lieu of a mandate are May 26, 1964 and June 22, 1964. The terms of the respective orders granted such stay until June 25, 1964 and July 25, 1964. The statutory provisions believed to confer on this Court jurisdiction to review the judgment in question by Writ of Certiorari are 28 U.S.C. § 1254, 28 U.S.C. § 2101 and 28 U.S.C. § 2106.

QUESTION PRESENTED

The question presented for review is whether Rule 23(b) of the Rules of Civil Procedure for the United States District Courts in this case requires or permits dismissal of a stockholder's secondary action, where the stockholder made no prior demand for relief from the directors of the corporation, under the allegations of the pleadings, the testimony of the plaintiff* and evidence presented to the Trial Court by the plaintiff.

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* The respondent, Meltzer, was the plaintiff in the District Court, petitioners were the defendants. Accordingly in this Petition defendants, appellees and petitioners are the same persons and plaintiff, appellant and respondent is the same person.

REGULATIONS INVOLVED

The prime regulation involved in this case is Rule 23(b) of the Rules of Civil Procedure for the United States District Courts. The pertinent portion of this Rule reads as follows:

> "Secondary action by Shareholder. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath. . . . *The complaint shall also set forth with particularity efforts of the plaintiff to secure from the managing directors . . . such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.*" (Italics supplied)

CONCISE STATEMENT OF THE CASE

This was a derivative stockholder's suit filed by the plaintiff* in the United States District Court for the Eastern District of Virginia. The jurisdiction of the Court was based on diversity of citizenship, the plaintiff being a citizen of New York and the defendants citizens of jurisdictions other than New York.

In his Amended Complaint plaintiff alleged that the personal defendants used funds of the corporate defendant (Atlantic) to purchase Atlantic's stock in order to protect their own personal investment, that the personal defendants benefited from these pur-

* An identical action was filed several days later by Herbert C. Sterenstein, Sarah Sterenstein and Joseph M. Newmark against Atlantic Research Corporation and other personal defendants including those in the instant case. Newmark was dismissed for failure to prosecute and the Sterensteins were dismissed at their request as parties to the appeal.

chases, that the personal defendants caused Atlantic to issue false financial statements and thereby sought to benefit themselves, that the personal defendants permitted Atlantic to finance other companies owned and managed by Atlantic's officers and employees, that defendants, Scurlock and Sloan, engaged in similar activities to their own benefit and to the loss of Atlantic. Plaintiff further alleged that demand upon the Board of Directors of Atlantic would be futile because the Board was controlled and dominated by the alleged wrongdoers (Scurlock and Sloan), that the Directors participated in the wrongs alleged, that the Directors negligently permitted the said wrongs to occur and that the institution of the derivative suit by the Directors would place the cause in hostile hands. (Appendix to Brief for Appellant, pp. 24a-31a).

Exhibit introduced by the plaintiff and affidavits attached to defendants' Motion showed the remedial action taken by the Directors before and during the time plaintiff's suit was being prepared. They removed Scurlock from his post as President and Chief Executive Officer of the Company, rescinded his power to commit corporate funds and even to draw checks, limited his authority to the normal operations of the business and required him to report to the Executive Committee. The Directors further obtained a guarantee of certain loans from the defendants, Scurlock and Sloan, took action respecting pledges securing bank loans, added two outside persons to the Board of Directors, set up an Executive Committee of three members including two outside directors, retained Price Waterhouse & Company as an independent accounting firm, selected an outside law firm as general counsel and authorized counsel to enter into a stipulation of facts with the Securities and Exchange Com-

mission contrary to the wishes of and over the objection of Scurlock. (Appendix to Brief for Appellant, pp. 24a-31a, Appendix to Brief for Appellee, pp. 5a-9a).

Information as to all these remedial steps was made available to the plaintiff after the hasty filing of his original Complaint on November 10, 1962, but well before the filing of his Amended Complaint on January 3, 1963.

The plaintiff himself, testifying through a pre-trial deposition, stated that he read the above report and that the report outlined the remedial action which the corporate defendant had taken. He was then asked if that was not the same remedial action he was requesting in his law suit, and he answered that he did not know, that he was not sure and that he did not pay too much attention to the report. (Appendix to Brief for Appellant, p. 20a, Appendix to Brief for Appellees, pp. 1a-4a, Appendix, *infra*, p. 16a).

After the filing of the pleadings, the taking of depositions and the filing of Memoranda of Authorities, the District Judge heard arguments on the defendants' Motion to Dismiss and rendered his opinion granting the Motion on May 29, 1963. (Appendix to Brief for Appellant, pp. 1a-23a). Meltzer appealed to the United States Court of Appeals for the Fourth Circuit, which Court reversed the judgment of the Trial Court and later denied appellees Petition for Rehearing. It is from the judgment of the Appellate Court that petitioner applies for this Writ of Certiorari.

ARGUMENT

Directly and concisely this case involves the vitality of Rule 23(b) of the Federal Rules of Civil Procedure. The decision of the District Court breathed life into the Rule. It upheld the spirit, the language and the purpose of the Rule. The decision of the Appellate Court killed the Rule. If the judgment of the Appellate Court were affirmed then Rule 23(b) might as well not have been put on the books.

The Rule provides that the plaintiff must set forth with particularity his efforts to secure from corporate directors such action as he desires. The remedy conferred upon him enabling him to file a derivative stockholders suit is an extraordinary remedy. To be entitled to this remedy a plaintiff must fulfill the requirements of the Rule.

Just as the privilege of bringing a derivative action is an extraordinary remedy, so the requirement of demand is a positive, constructive, preventive remedy. The purpose of the requirement of demand is to prevent litigation not to encourage it, to enable directors to settle their differences with stockholders before they go into Court, not to throw upon the Court the burden or upon the parties the expense, of asking a Judge to decide questions of fact that intelligent parties can decide between themselves. The requirement of demand envisages solutions not suits.

As stated by this Court in *Hawes* v. *Oakland*, 104 U.S. 450, 26 L. Ed. 827, "But, in addition to the existence of grievances which call for this kind of relief, it is equally important that . . . the shareholder . . . should show . . . that he has exhausted all the means within his reach to obtain, within the corporation it-

self, the redress of his grievances, or acton in conformity to his wishes." (104 U.S. 460-61, 26 L. Ed. 832).

"Here abides the ancient faith in the right of men to choose their own associates, make their own arrangements, govern themselves and thus grow in responsibility without much in the way of either hindrance or help from the state . . . Unsupported minority stockholder suits have been considered appropriate only where no fair forum except the Court was available." *Pomerantz* v. *Clark* (U.S.D.C. Mass. 1951, 101 F. Supp. 341, 346).

In the instant case the Directors of Atlantic Research Corporation did take remedial action. Perhaps they did not conceive of or perform all of the acts cited as possibilities by the Court of Appeals. But they did take action, dramatic action, effective action and more salutary action than has been taken in any case to which reference has been made in this litigation. As pointed out by the District Judge this case is unique in that the remedial activity was going on at the very time the plaintiff was preparing his suit. For that reason alone the necessity of demand is particularly important in the instant case.

Indeed it is significant that the plaintiff himself at the time of taking his deposition, long after the filing of his Amended Complaint, did not know what other remedial action he desired. As the District Judge pointed out, if the plaintiff did not know what further remedial action he wanted, it ill behooved him to come into Court and ask the Court to advise him. (Appendix, *infra*, p. 16a).

We repeat, in no other case cited by either party to this litigation has such effective and comprehensive remedial action been taken without any demand.

The presumption is that had demand been made and had specific remedies been suggested, they, too, would have been granted. The respondent made many averments of his own conclusions against all of the Directors besides Scurlock and Sloan. He did not make specific allegations of fact against these other Directors and he did not seek to charge them with misfeasance, rather he sought to catch them in a net-like charge of nonfeasance. Again the presumption would be that directors who were ignorant of impugned acts of other directors would be the first to remedy the alleged wrongs once they were called to their attention. An intelligent demand in the instant case would have brought the remedy and obviated the suit.

As the District Judge stated in his opinion, the question before the Court was not whether the Directors had given all the relief the plaintiff sought. The question is whether Rule 23(b) has been complied with and whether in the light of the evidence before the Court, the allegations of the Complaint were sufficient to excuse the demand. The Court felt that an aggregation of general conclusions did not justify the failure to make a demand. His decision was correct, because otherwise irresponsible averments of conclusions would nullify and destroy the usefulness of Rule 23(b).

The decision of the Court of Appeals for the Fourth Circuit in this case is contrary to the decision in *Levitan* v. *Stout* (D.C. W.D. Ky. 19..), 97 F. Supp. 105, and interprets erroneously the decision of this Court in *Delaware & Hudson Company* v. *Albany & Susquehanna Railroad Co.*, 213 U.S. 435, 53 L. Ed. 862 (1909). In the latter case involving the claim of one company against another with interlocking boards of directors, no remedial action had been taken and was not even foreseeable in view of the "unique" situation.

Moreover, the instant case involves an important question of Federal law which has not been, but should be settled by this Court. In this day of corporate activity important to the economy of the country and in the instant case important to the welfare of thousands of people within and beyond the boundaries of Virginia, it is essential that corporations be allowed to put their own houses in order before being thrown into the Courts by irresponsible or premature actions of minority stockholders.

This Court is a jealous guardian of the rules which it has promulgated for civil procedure in the United States District Courts. In numerous cases it has granted certiorari and has considered and defined the exact meaning of the Rules. For example see:

Rule 4(d)1. *National Equipment Rental* v. *Szukhent*, U.S. , 11 L. Ed. 2d 354, 84 S. Ct. (1964).

Rules 6(h) and 25(a). *Anderson* v. *Yungkau*, 329 U.S. 482, 91 L. Ed. 436, 67 S. Ct. 428 (1947).

Rule 50(b). *Johnson* v. *New York, New Haven & Hartford Railroad Company*, 344 U.S. 48, 97 L. Ed. 77, 73 S. Ct. 125 (1952).

Rule 53(b). *LaBuy* v. *Howes Leather Co.*, 352 U.S. 249, 1 L. Ed. 2d 290 (1957), rel. den. 352 U.S. 1019, 1 L. Ed. 2d 50.

Rule 54(b). *Cold Metal Process Company* v. *United Engineering & Foundry Company*, 351 U.S. 445, 100 L. Ed. 1311 (1956).

Rule 71A(h). *United States* v. *Merz*, U.S. , 11 L. Ed. 2d 629, 84 S. Ct. (1964).

Indeed this Court has held that the extraordinary remedy of mandamus lies for the purpose of compelling compliance with the Federal Rules of Civil Procedure. *McCullough* v. *Cosgrove*, 309 U.S. 634, 84 L. Ed. 992, 60 S. Ct. 703 (1940).

CONCLUSION

If Rule 23(b) means what it says and if as indicated above its spirit, its letter and its purpose are to be fulfilled, then this Court should reverse the judgment of the United States Court of Appeals for the Fourth Circuit and reinstate the judgment of the United States District Court for the Eastern District of Virginia.

Respectfully submitted,

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